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August 12, 1997

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

VIA HAND DELIVERY

Mr. William Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: In the Matter of Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, IB Docket No. 97-142

Dear Mr. Caton:

Telefónica Internacional de España, S.A. ("Telefónica Internacional"), by its attorneys, hereby submits for filing an original and nine copies of its Reply Comments in connection with the above-captioned matter.

Also enclosed is an additional copy of Telefónica Internacional's Reply Comments which we ask you to date stamp and return with our messenger.

If you have any questions, please do not hesitate to contact me.

Respectfully submitted,

Alfred M. Mamlet
Colleen A. Sechrest
Counsel for Telefónica Internacional
de España, S.A.

Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of **Rules and Policies on Foreign Participation in the U.S. Telecommunications Market**	**IB Docket No. 97-142**

REPLY COMMENTS OF TELEFÓNICA INTERNACIONAL DE ESPAÑA, S.A.

Dated: August 12, 1997

TELEFÓNICA INTERNACIONAL DE ESPAÑA, S.A.

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FEDERAL COMMUNICATIONS COMMISSION
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REPLY COMMENTS OF TELEFÓNICA INTERNACIONAL DE ESPAÑA, S.A.

I. INTRODUCTION AND SUMMARY

Telefónica Internacional de España, S.A. ("Telefónica Internacional") hereby submits its Reply Comments in the above-referenced proceeding. Along with most other commenters, Telefónica Internacional supports the Commission's proposal to replace its current effective competitive opportunities ("ECO") standard with a policy of open entry for Section 214, Title III common carrier, and cable landing license applications submitted by affiliates of carriers from WTO countries.[1/] As many

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[1/] *In the Matter of Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, Order and Notice of Proposed Rulemaking*, IB Docket No. 97-142 (rel. June 4, 1997) ("NPRM").

commenters point out, the WTO Agreement on Basic Telecommunications Services ("WTO Telecom Agreement"), which brings telecommunications services within the purview of the General Agreement on Trade in Services ("GATS"), both obviates the need for the Commission's current entry restrictions and obligates the Commission to eliminate them.[2/]

The Commission's NPRM goes a considerable way towards establishing the open entry standard required by the WTO Telecom Agreement by proposing to permit entry except where there is a demonstration of a very high risk of anticompetitive consequences in the U.S. telecommunications market. However, this standard does not go far enough. In particular, this standard is not only vague, but also leaves considerable room for administrative discretion. As a result, it does not provide carriers from WTO countries with the certain and predictable entry that the WTO Agreement requires.

AT&T Corp. ("AT&T"), unsatisfied with the Commission's cautious approach, takes the extreme position that the WTO Telecom Agreement should have virtually no impact on the Commission's foreign entry standard. AT&T argues not only that the Commission's ECO test remains necessary in a post-WTO Telecom Agreement environment, but that this test is permissible under the GATS. Neither assertion is correct. The WTO Telecom Agreement does, in fact, dramatically reduce the need for a strict entry standard by opening up telecommunications markets around the globe. Moreover, no exception in either the GATS or the Reference Paper[3/] permits the United States to adopt an entry standard which compromises the core GATS principles of MFN, national treatment and market access. AT&T's position, if correct, would leave

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[2/] NPRM ¶¶ 1-3.

[3/] Reference Paper, § 1.1, *attached to* Communication from the United States, WTO Doc. S/GBT/W/1/Add.2/Rev.1, at 5 (Feb. 15, 1997).

these principles devoid of any meaning -- and the Agreement equally devoid of any effect -- in the global telecommunications market.

AT&T also argues that, at a minimum, the Commission should condition authorizations on settlement rates at the low end of the benchmarks in its settlement rate proceeding.[4/] According to AT&T, without such a condition, foreign carriers can use their U.S. affiliates to "price squeeze" their unaffiliated competitors in the U.S. market. While the Commission's settlement rate decision (which has not yet been released) apparently adopted this argument, the Commission should reject this condition on both policy and legal grounds. No rational foreign carrier would attempt such a "price squeeze" because it would not be profitable to do so. Additionally, as with the Commission's ECO test, conditioning authorizations on compliance with the Commission's benchmarks -- whether at the high or the low end -- conflicts with core GATS principles.

In short, by interpreting the WTO Telecom Agreement to permit Member countries to maintain the status quo, AT&T seeks to nullify the impact of that Agreement on the U.S. telecommunications market. This would have serious consequences for the rest of the world as well. For if the United States does not abide by its commitment to open its market to foreign competition, it is unlikely that other countries will either. As a result, the WTO Telecom Agreement would be an agreement on paper only, and the benefits of increased competition that it promises to consumers in the U.S. and around the world would simply never materialize.

4/ *In the Matter of International Settlement Rates, Notice of Proposed Rulemaking*, IB Docket No. 96-261 (rel. Dec. 19, 1996) ("*Benchmarks NPRM*").

II. THE WTO AGREEMENT COMPELS THE COMMISSION TO REPLACE ITS ECO TEST WITH AN OPEN ENTRY STANDARD

As the Commission's NPRM acknowledged, the WTO Telecom Agreement compels the Commission to replace its restrictive ECO test with an open entry standard for Section 214, Title III common carrier and cable landing license applications for all carriers affiliated with carriers from WTO countries.[5/] The Commission's NPRM takes a significant step in this direction by proposing to permit entry except where there is a very high risk of anticompetitive behavior in the U.S. market.[6/] The Commission's proposal, however, does not go far enough. Specifically, the Commission's proposal does not provide foreign carriers with the clear certainty that they will have access to the U.S. market -- the fundamental commitment made by the United States in the WTO Telecom Agreement. The Commission should thus revise its proposals to meet this commitment fully.

AT&T, however, believes that even this conservative Commission approach goes to far. According to AT&T, the WTO Agreement neither eliminates the need for, nor requires the Commission to eliminate, its current ECO standard.[7/] This position is without merit. The WTO Agreement clearly changes the global telecommunications environment, and does so by committing countries, including the United States, to open their markets to foreign carriers. AT&T's arguments would gut these commitments by permitting the U.S. and other WTO Members to selectively implement the WTO Agreement -- to limit competition in the name of protecting

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5/ NPRM ¶¶ 32, 62 & 68.

6/ *Id.*

7/ Comments of AT&T at ii.

competition. The Commission should resist such an invitation to jeopardize the successful efforts of 69 countries to increase competition around the world.

A. The Commission's Proposals Are Insufficient to Implement the United States' WTO Commitments

The Commission's proposals are insufficient to implement the United States' WTO commitment to open its markets to foreign carriers. Specifically, the Commission proposes to permit entry except where there is a demonstration of a very high risk of anticompetitive behavior in the United States telecommunications markets.[8/] While this proposed standard is a significant improvement over the Commission's ECO test, it falls short of the U.S. WTO commitment to permit foreign carrier entry in two ways: (1) the proposed standard could be used to deny foreign-affiliated carriers' applications based on impermissibly vague criteria; and (2) the standard retains an unacceptable level of Commission discretion to deny licenses based on ill-defined public interest factors.

First, the Commission's standard is problematic in that an application by a carrier from a WTO country could be contested and denied if "grant of the application would pose a very high risk to competition in the U.S. telecommunications market that could not be addressed by conditions that we could impose on the authorization."[9/] By opening the door to U.S. competitors to challenge applications from WTO carriers based on such vague criteria as a "very high risk," the Commission erodes the principle of market access to which the U.S. commited in the WTO Telecom Agreement. As the European Union noted in its Comments:

> Such an approach would erect additional burdens on foreign companies wishing to enter the U.S. market, which would be subject to challenges by their competitors based on unclear

[8/] NPRM ¶¶ 32, 62 & 68.

[9/] NPRM ¶ 32.

> conditions and criteria. The European Community and its Member States have concerns about the compatibility of such broad and vague competition policy objectives with the GATS/WTO Agreement . . .[10/]

The Commission must revise its proposed standard to ensure full GATS compatibility.

Second, the Commission's proposed entry standard retains a troubling degree of discretion to deny licenses on the basis of public interest factors, such as "national security, law enforcement, foreign policy, or trade concerns brought to our attention by the Executive Branch."[11/] While the GATS has a specific limited "national security" exception,[12/] the denial of an authorization to a carrier from a WTO country based on these other grounds is not appropriate. Indeed, as of January 1, 1998, it will be the foreign policy and trade policy of the United States to permit entry to carriers from WTO countries. Accordingly, these public interest factors compel entry. Again, in the words of the European Union:

> We believe that the US endorsement of the WTO Agreement on Basic Telecoms clearly indicates that WTO Members already satisfy the public interest objectives contained in the Notice, which thus cannot be applied to WTO Members.[13/]

At a minimum, the retention of such broad public interest discretion "would raise legitimate doubts that the Commission's rules provide the 'reasonable, objective and impartial' framework for foreign competition required by the General Agreement on Trade in Services."[14/] Accordingly, the Commission should revise its approach to create

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10/ Comments of the European Union at ¶ 9. *See also* Comments of Sprint at 9.

11/ NPRM ¶ 47.

12/ GATS, art. XIV *bis*:1.

13/ Comments of the European Union at ¶ 8 (emphasis in original).

14/ Comments of Sprint at 10 (*citing* NPRM ¶ 6.). *See also* Comments of the European Union at ¶ 8.

only a narrow exception for "national security" policy, consistent with the U.S. GATS commitments.

As the European Union states in its Comments:

> [I]t is essential at this stage to avoid taking any action that may jeopardise the effective implementation of the commitments undertaken by the WTO Member countries under the Agreement. Major trading nations, and those which pursued most actively the successful conclusion of the negotiations, bear a special responsibility in this respect. **In this context, the European Community and its Member States have concerns with the potential negative impact that the rules proposed in [the] NPRM could have on the implementation of the commitments of the other WTO Member countries.**[15/]

By insisting on a strong WTO Telecom Agreement, the U.S. brought most of the world to the threshold of opening telecommunications markets. Now, the U.S. must again lead the way by implementing its commitments fully to encourage others to follow.

B. Contrary to AT&T's Arguments, the WTO Telecom Agreement Not Only Obviates the Need for the ECO Test, but Obligates the Commission to Eliminate It

AT&T takes the extreme approach of arguing that even the Commission's cautious implementation of the WTO Telecom Agreement goes to far. According to AT&T, this Agreement neither changes the global telecommunications market enough to warrant elimination of the Commission's current ECO standard, nor requires the U.S. to permit open entry by companies from WTO countries. As demonstrated below, AT&T's position is completely untenable.

15/ Comments of the European Union at ¶ 5 (emphasis in original).

1. The WTO Telecom Agreement Eliminates the Need for the ECO Standard

AT&T argues that the WTO commitments made by other countries are an insufficient basis on which to relax the Commission's entry standard because only "25 countries would meet ECO requirements by 2000, and 39 countries would do so in total by the time all WTO commitments are effective in 2013."[16/] AT&T, however, loses sight of the forest for the trees. For, as the Commission recognized in the NPRM, the WTO commitments of 69 countries, embracing nearly 95% of the world's basic telecommunications services market, "substantially achieve the paramount goal of . . . promoting effective competition in the U.S. international services market."[17/] This is because these commitments do, in fact, meet the two key requirements of the ECO test: opening up monopoly markets to competition and ensuring that these markets are regulated according to fair, objective and procompetitive principles. Retention of the ECO test would thus be unnecessary.

2. The WTO Telecom Agreement Requires the Commission to Eliminate the ECO Test

The WTO Telecom Agreement requires the Commission to completely eliminate its restrictive ECO test. AT&T, however, appears to believe that only a slight modification to this test is necessary to make it compatible with the United States' WTO commitments. This is simply not the case. As demonstrated below, the Commission's ECO test, even with AT&T's proposed modification, violates the core GATS principles of MFN, national treatment and market access and thus must be eliminated. Moreover, neither Article VI of the GATS nor Section 1.1 of the Reference Paper, on which AT&T relies, permit any deviation from these core GATS principles.

16/ Comments of AT&T at 9.

17/ NPRM ¶¶ 2 & 29.

a. AT&T's Modified ECO Test Clearly Conflicts with the Core GATS Principles of MFN, National Treatment and Market Access

AT&T argues that the WTO Telecom Agreement requires only a slight modification to the Commission's existing ECO standard. Specifically, AT&T suggests that:

> the present requirements should be modified to examine whether the relevant country has implemented WTO commitments (1) to provide unrestricted market access for the provision of the relevant service, (2) to allow the foreign ownership of controlling interests in carriers providing the relevant service, and (3) to meet the requirements of the GATS Reference Paper.[18/]

AT&T's "modification" would represent little real change from the Commission's ECO standard, which requires (under Title II) that U.S. carriers (1) have market access to provide facilities-based international services; and (2) have the benefit of an independent regulator and regulations requiring non-discriminatory treatment.[19/] Indeed, AT&T would pile on to the ECO test a requirement for cost-based settlement rates[20/] that the Commission specifically rejected when adopting the ECO test.[21/] Thus, with or without AT&T's proposed modification, the ECO standard is, in the words of the European Union, "clearly against the spirit of open market entry underlying the WTO Agreement and against the U.S. commitments under such Agreement."[22/]

18/ Comments of AT&T at 18.

19/ 47 C.F.R. § 63.18(h)(6).

20/ Coments of AT&T at 25.

21/ *In the Matter of Market Entry and Rgulation of Foreign-affiliated Entities*, 11 FCC Rcd. 3873, 3898 (1995).

22/ Comments of the European Union at ¶ 16.

AT&T's proposed standard conflicts with the United States' GATS commitments in two critical respects.[23/] **First**, it conflicts with the U.S. commitment to afford MFN treatment to all WTO countries. This obligation is set out in Article II:1 of the GATS:

> [E]ach [WTO] Member shall accord immediately and unconditionally to **services and service suppliers** of any other Member, treatment no less favorable than that it accords to like services and service suppliers of any other country.

In other words, a Member cannot open up its market to carriers from some WTO countries but not others. Yet this is precisely what AT&T's proposed test is designed to do. It does this by allowing entry only to foreign carriers from countries whose markets the Commission determines afford U.S. carriers unrestricted market access.

AT&T's proposed modification actually makes the ECO standard even more MFN-inconsistent because it proposes not only to make distinctions between WTO countries, but to do so on the basis of their WTO commitments. This flies in the face of another fundamental GATS principle: a Member must implement its own commitments irrespective of the nature of another Member's commitments or whether that Member has complied with its commitments.[24/] In other words, the United States cannot deny entry to a carrier from another WTO country simply because it is not satisfied with the level or implementation of that country's commitments.

[23/] As even AT&T recognizes, the Commission's current ECO standard would also violate the GATS national treatment obligation, as it it sets up a completely different entry standard for foreign and foreign-affiliated carriers than its does for U.S. carriers with investments in foreign carriers. *See* Comments of AT&T at 18, n. 28.

[24/] WTO Understanding on Rules and Procedures Governing the Settlement of Disputes, April 15, 1995, art. 23 (requiring disputes over implementation of WTO commitments to be resolved only through WTO dispute resolution).

Second, and most fundamentally, AT&T's proposed ECO standard violates the U.S. commitment of market access. This commitment is set forth in Article XVI:1:

> [E]ach [WTO] Member shall accord services and service suppliers of any other Member treatment no less favorable than that provided for under the terms, limitations and conditions agreed and specified in its [GATS] Schedule.

The United States' Schedule binds it to open its international telecommunications market to foreign carriers from WTO countries. The **only** exceptions are for national security and in the limited areas explicitly reserved by the U.S. in its commitment.[25/] The FCC is thus foreclosed from using any standard, including the ECO standard, to afford access to carriers from some WTO countries but not others. Indeed, it is this unqualified commitment to market access which requires the Commission to adopt an equally unqualified open entry standard.

b. There Are No GATS Exceptions which Permit a WTO Member to Violate Core GATS Principles

In the face of these clear GATS violations, AT&T nevertheless argues that Article VI of the GATS, together with 1.1 of the Reference Paper, permit the Commission to maintain the ECO standard.[26/] This argument is without merit, as the ECO standard clearly conflicts with key elements of both provisions. In addition, nothing in these provisions entitles Members to adopt regulations which compromise fundamental GATS commitments.

[25/] The United States reserved the right to apply limited exceptions to its commitments on commercial presence, with respect to: (1) direct foreign ownership of common carrier licenses; and (2) access to the Intelsat and Inmarsat systems. *See* Communication from the United States, WTO Doc. S/GBT/W/1/Add.2/Rev.1 (Feb. 15, 1997).

[26/] Comments of AT&T at 15-21.

Article VI of the GATS provides that "each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner."[27/] In addition, Article VI provides that "measures relating to qualification requirements and procedures, technical standards and licensing requirements [may] not constitute unnecessary barriers to trade in services," and must be:

> (a) based on objective and transparent criteria, such as competence and the ability to supply the services;
>
> (b) not more burdensome than necessary to ensure the quality of the service; [and]
>
> (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.[28/]

AT&T's proposed ECO standard would clearly conflict with these criteria because it (1) is not related to competence or ability to supply services; (2) is not related to ensuring the quality of service; and (3) does impose significant restrictions on the supply of service. Indeed, AT&T's proposed ECO test is so restrictive that, as AT&T itself points out, many WTO countries cannot yet meet it.[29/]

Section 1.1 of the Reference Paper expressly provides that "Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices."[30/] This provision allows the United States to impose regulations to prevent major suppliers **in the U.S. market**, not in other markets, from engaging in

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27/ GATS, art. VI:1.

28/ GATS, art. VI:4.

29/ Comments of AT&T at 9.

30/ Comments of AT&T at 15-16.

anti-competitive practices. This is a view shared by the European Union, which states in its Comments:

> The European Community and its Member States note the approach adopted in the European Community of a regulatory framework, which include competition rules, based on the GATS principles of reasonableness, objectivity, impartiality and transparency, all of which are fully in line with the Reference Paper, aimed at preventing 'major suppliers from engaging in or continuing anti-competitive practices'. The European Community and its Member States note that their rules do not allow the denial of licenses by an EC Member State to carriers which "might" be a major carrier in another [Member State] even if they engage in anti-competitive behavior at a later stage.[31/]

In other words, it is completely immaterial to Section 1.1 whether a foreign carrier is a major supplier in a foreign market -- the threshold issue in the Commission's ECO test. Rather, Section 1.1 is intended to permit regulation of dominant local providers such as the RBOCs, or perhaps AT&T.

Furthermore, Section 1.1 represents an additional commitment pursuant to article XVIII of the GATS and does not supersede any other GATS obligations.[32/] To hold otherwise would be to permit GATS members to undermine the fundamental market-opening purpose of GATS by raising regulatory trade barriers in the guise of anti-competitive safeguards.

In sum, AT&T proposes that the Commission interpret the WTO Agreement in a way which permits the United States to evade its core GATS obligations. Such an interpretation would send a clear signal to the rest of the world that the United States will not provide open entry to its market. This action would have grave consequences throughout the world. Instead of encouraging other countries to

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31/ Comments of the European Union at ¶ 7 (emphasis removed).

32/ Comments of Telefónica Internacional at 14.

open their markets fully, the Commission would be giving other countries the excuse to restrict entry.

III. CONDITIONING ACCESS TO THE U.S. MARKET ON SETTLEMENT RATES WITHIN THE PROPOSED BENCHMARKS IS BOTH UNNECESSARY AND GATS-ILLEGAL

As Telefónica Internacional demonstrated in its Comments both in this proceeding and in the Commission's Benchmarks proceeding, conditioning access to the U.S. market on settlement rates within the Commission's proposed benchmarks is both unnecessary and illegal under the GATS. AT&T, however, asserts that such a condition is necessary because settlement rates above the benchmark range provide a foreign-affiliated carrier with a unfair competitive advantage in the U.S. market.[33/] More specifically, AT&T claims that above-cost settlement rates allow foreign carriers with U.S. affiliates to "price squeeze" their unaffiliated competitors.[34/] However, no rational foreign carrier would attempt such a "price squeeze" because it would lose money. This is hardly a basis on which to establish a condition which effectively prohibits entry to carriers from all but 9 WTO countries.

A. High Settlement Rates Do Not Lead to "Price Squeezes" in the U.S. Market

Contrary to the claims of AT&T, above-cost settlement rates do not lead to uncompetitive "price squeezes" in the U.S. market.[35/] AT&T bases its claim on the

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33/ Comments of AT&T at 25.

34/ *Id.*

35/ *Id.*

theoretical model described by Professor William H. Lehr.[36/] Under this model, a foreign carrier can generate additional settlement revenue by establishing a U.S. subsidiary.[37/] This subsidiary can lower prices, thereby generating more revenue through increased calls.[38/] At the same time, unaffiliated U.S. carriers are forced to match these lower prices in order to maintain their market share.[39/] As these U.S. carriers are already pricing at cost, any price decrease will result in a loss for them.[40/] At the same time, the losses that the affiliated carrier suffers is more than made up for by the increase in settlement rate revenue.[41/] The result: "U.S. carriers could suffer losses at levels that would be 'unlikely to be sustainable without severe harm to US industry and consumers.'"[42/]

The scenario that Professor Lehr describes is completely unrealistic. This is because Professor Lehr's model is based on several erroneous assumptions about the U.S. telecommunications market, including: (1) that the U.S. market is competitive and U.S. carriers price at cost; (2) that U.S. consumers readily switch all their domestic long distance and international traffic between carriers in response to a price reduction on one international route; and (3) that U.S. carriers will lower their prices in response

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36/ Comments of AT&T at Attachment 3, Affidavit of William H. Lehr ("Lehr Affidavit").

37/ Professor Lehr refers to this settlement revenue as an anti-competitive "subsidy." As Telefónica Internacional argued at length in its Comments filed in the Commission's *Benchmarks* proceeding, this revenue is not an anti-competitive subsidy, but rather an essential source of funding for vital development and universal service programs. *See* Comments of Telefónica Internacional filed in IB Docket 96-261 at 40-45 & 50-55.

38/ *Id.* at 26; Lehr Affidavit at 13-15.

39/ Comments of AT&T at 26; Lehr Affidavit at 15-16 & 18-19.

40/ Comments of AT&T at 26; Lehr Affidavit at 15-16 & 18-19.

41/ Comments of AT&T at 26; Lehr Affidavit at 13-15.

42/ Comments of AT&T at 26 (*citing* Lehr Affidavit at 16).

to a price reduction by a foreign-affiliated carrier. In order for Mr. Lehr's model to work, each of these assumptions must hold true. As demonstrated below, none do. As a result, a rational foreign carrier would not attempt to use its U.S. affiliate to "price squeeze" its U.S. competitors. Indeed, if it did, it would lose more revenue than it would gain -- hardly an incentive to engage in anti-competitive conduct.

1. U.S. Carriers Do Not Price at Cost

One of the most critical assumptions that Professor Lehr makes is that the U.S. market is sufficiently competitive that U.S. carriers price their services at cost.[43/] Accordingly, these carriers will incur losses if forced to lower their prices in response to a price cut by a foreign-affiliated competitor. However, as the Commission itself acknowledged in the *Benchmarks NPRM*, there is only "limited competition in the [U.S.] IMTS market."[44/] As a result, U.S. carriers are able to operate with huge margins -- an average of $0.55 per minute on international calls.

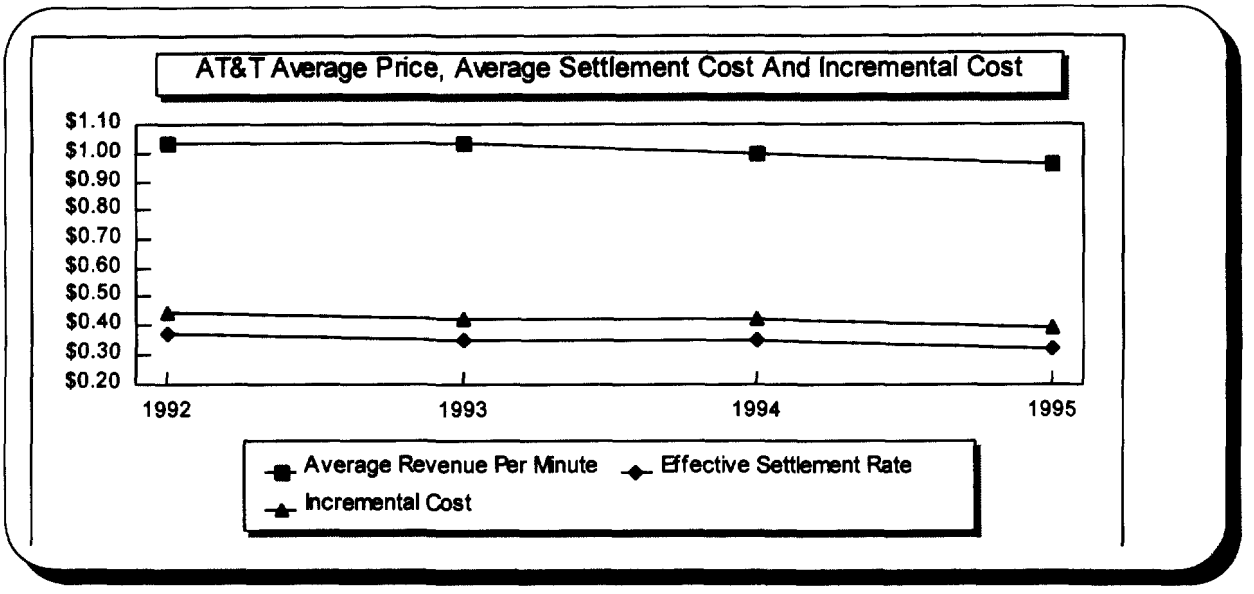
AT&T itself provides an excellent example of the excessively high margins that U.S. carriers currently enjoy. Using the data that AT&T itself provided in the *Benchmarks* proceeding, Figure 1 plots AT&T's average revenue per minute against its incremental cost of providing IMTS.[45/]

43/ Lehr Affidavit at 14.

44/ *Benchmarks NPRM* ¶ 9.

45/ Comments of AT&T filed in IB Docket IB Docket No. 96-261 at 11, Chart B (filed Feb. 7, 1997) (Figure 1 replicates AT&T's Chart B and adds a new line showing the incremental cost to AT&T of providing IMTS, based on the "effective settlement rate" calculated by AT&T and the $0.075 per minute average network cost figure supplied by AT&T).

Figure 1



The entire region between AT&T's average revenue per minute (top line with squares) and AT&T's incremental cost (middle line with triangles) is AT&T's margin above incremental cost. According to AT&T's own calculations, its margin for IMTS was at least $0.565 per minute each year. With margins of this magnitude, any price reductions up to $0.565 per minute by a foreign-affiliated carrier would be pro-competitive because U.S. carriers can reduce their prices by this amount (even with no change in the settlement rate) **without** pricing below incremental cost. This additional competition should be welcomed by the Commission and U.S. consumers, if not by AT&T.

2. U.S. Consumers Will Not Switch All of Their Traffic to a Carrier on the Basis of Lower IMTS Prices

Professor Lehr also assumes that consumers are extremely sensitive to price decreases and will readily switch to a different carrier to take advantage of lower IMTS rates. Professor Lehr also contends that "customers who leave to take advantage of cheaper calls . . . are likely to take all of their traffic to the new carrier

(including domestic long distance and local service business)."[46] As a result, according to Professor Lehr, when a foreign-affiliated carrier lowers prices, its U.S. competitors will be forced to follow suit in order to retain their market share.[47]

This assumption is completely unsupported and unfounded. Customers are indeed price sensitive. However, Professor Lehr offers no evidence that a significant number of customers would switch all of their domestic long distance and international traffic on the basis of a lower rate on one country pair route. In reality, virtually all customers select their carrier on the basis of the basket of prices for domestic long distance service and all international routes. Thus, a foreign-affiliated carrier would have to reduce prices for U.S. domestic long distance and IMTS on **all** of its routes in order to induce a significant number of customers to switch carriers. In other words, it is very unlikely that the $0.10 per minute price cut on a single affiliated route posited by Professor Lehr in his model will force U.S. carriers to similarly cut their prices to retain their market share.

3. U.S. Carriers Will Not Lower Prices, and thus Incur Losses, in Response to a Price Cut by a Foreign-Affiliated Carrier

Even if Professor Lehr's other assumptions held true, it would be irrational for U.S. carriers to lower their prices to match a price cut by a foreign-affiliated carrier. Using Professor Lehr's own assumptions, Table 1 calculates the **losses** incurred by foreign-affiliated carrier with at 10% market share whose $0.10 price cut goes unmatched by its unaffiliated competitor. These losses increase as the foreign affiliated carrier's market share increases from 10% to 50%. This example demonstrates that a rational foreign carrier would not price below cost because it would lose money, even considering increased settlement revenue from increased traffic.

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[46] Lehr Affidavit at 19.

[47] *Id.*

Table 1

Using Dr. Lehr's Assumptions, Foreign Carries Lose Money if U.S. Carriers Keep Prices at Cost

Assumptions (all prices and costs are in dollars per minute):[48/]

Price for US carriers		$0.40		Price for US based foreign subsidiary	$0.30	
Cost for US carriers		$0.40		Cost for US based foreign subsidiary	$0.40	
Settlement rate		$0.25		Demand elasticity	0.7	
	Base Case	**Losses incurred by a foreign-affiliated carrier with a $0.10 price reduction and increasing market share**				
Percent market share of foreign affiliated carrier	10%	10%	20%	30%	40%	50%
Average market price[1/]	$.40	$0.39	$0.38	$0.37	$0.36	$0.35
Change in market price[2/]	0	-2.5%	-5%	-7.5%	-10%	-12.5%
Change in total minutes[3/]	0	1.75%	3.5%	5.25%	7%	8.75%
Total minutes[4/]	1,000,000	1,017,500	1,035,000	1,052,500	1,070,000	1,087,500
Total minutes of foreign affiliated carrier[5/]	100,000	101,750	207,000	315,750	428,000	543,750
Profit/loss of U.S. carrier[6/]	0	$0	$0	$0	$0	$0
Profit/loss of foreign-affiliated carrier[7/]	0	-$10,175	-$20,700	-$31,575	-$42,800	-$54,375
Increase in settlement payments[8/]	0	$4,375	$8,750	$13,125	$17,500	$21,875
Consolidated net profit/loss to foreign-affiliated carrier and foreign carrier[9/]	0	**-$5,800**	**-$11,950**	**-$18,450**	**-$25,300**	**-$32,500**

1/ Average market price is the weighted average of the U.S. carrier and the affiliated carriers prices.

2/ Percent change in market price is the percentage difference between the Base Case market price of $0.40 and the average market price.

3/ Percent change in total minutes in the percent change in market price multiplied by the demand elasticity of 0.7.

48/ All assumptions are from Professor Lehr's Affidavit. *See* Lehr Affidavit at 13-15.

4/ Total minutes are the Base Case minutes (1,000,000) plus the precentage change in minutes multiplied by the Base Case minutes.

5/ Minutes for the foreign-affiliated carrier are total minutes multiplied market share.

6/ Profit/loss of the U.S. carrier is price ($0.40) minus cost ($0.40) multiplied by minutes.

7/ Profit/loss of foreign-affiliated carrier is price ($0.30) minus costs ($0.40) multiplied by minutes.

8/ Increase in settlement payments is settlement rate ($0.25) multiplied by the increase in minutes.

9/ Consolidated net gain to foreign-affiliated carrier and foreign carrier is price ($0.30) minus costs ($0.40) multiplied by minutes plus settlement increase.

Table 1 clearly demonstrates that U.S. carriers are better off if they do not respond to the price cut of a foreign affiliated carrier and continue to price at cost. In this way, U.S. carriers ensure that they do not sustain losses, even if they lose market share. At the same time, they ensure that their foreign-affiliated carriers do sustain significant losses. Moreover, these losses increase both as the foreign-affiliated carrier decreases its price and as it gains market share. In short, Professor Lehr's assumption that a U.S. carrier will match a foreign affiliated carrier's price cut is completely irrational, as it assumes that U.S. carriers will act against their own best interests. Recognizing that U.S. carriers will act rationally, a rational foreign-affiliated carriers will not incur the significant and inevitable losses by attempting a price squeeze. For this reason, there is no rational basis for the Commission to conclude that a foreign-affiliated carrier could or would attempt a price squeeze.[49/]

Accordingly, there is no merit to AT&T's argument that the authorizations of foreign-affiliated carriers must be conditioned on their affiliated carriers' compliance

49/ *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 113 S.Ct. 2578, 2588 (1993) (*citing Masushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588-89 (1986)).

with the Commission's proposed benchmarks in order to deter anti-competitive conduct in the U.S. telecommunications market.

B. Conditioning Entry on Compliance with Mandatory Benchmarks Conflicts with U.S. GATS Obligations

Conditioning the authorizations of foreign-affiliated carriers on their foreign affiliates' compliance with the Commission's proposed benchmarks is not only unnecessary, but is also inconsistent with the United States' commitments under GATS. As Telefónica Internacional demonstrated in its Comments, such a condition directly conflicts with U.S. MFN, national treatment and market access obligations.[50/] Most significantly, such a condition would simply create an entry standard that is as difficult to meet as the Commission's current ECO test. Indeed, carriers from only 9 WTO countries will be able to meet this standard as proposed by the Commission. Thus, carriers in the remaining 122 WTO countries would not have access to the U.S. market.[51/] In short, this condition would create a new entry barrier to carriers from more than 93% of WTO countries. Such a barrier is as antithetical to the market opening purpose of the GATS as is the ECO test itself.

IV. CONCLUSION

For the foregoing reasons, Telefónica Internacional urges the Commission to adopt the NPRM's proposals to replace its ECO test with a policy of unqualified open entry for carriers from WTO countries, without conditioning the authorizations of foreign-affiliated carriers on compliance with mandatory benchmarks.

50/ Comments of Telefónica Internacional at 12-14. *See also* Reply Comments of Telefónica Internacional filed in IB Docket No. 96-261 at 10-22.

51/ *Compare FCC Consolidated Accounting Rates of the United States* (July 1, 1997) *with Benchmarks Notice* at Appendix B.